

# FRANCHISING FACTS

Government  
Publications

CA20N

CC

- 74B723

DEPOSITORY LIBRARY MATERIAL

LIBRARY

OCT 25 1978

OF TORONTO



Ontario

Ministry of  
Consumer and  
Commercial  
Relations



CA20N  
CC  
-74B723

It seems so secure, so profitable; a dream come true. But watch out . . . being a franchisee can be a risky business. Last year in Ontario many hardworking men and women lost thousands of dollars through faulty or ill-planned schemes. Others have found franchising to be a successful business method. The difference is careful planning.

Your best defence against an unwise franchising investment is knowledge. For that reason, the ministry of consumer and commercial relations has prepared this booklet for you. Please read it carefully before you invest.





## What is franchising?

Franchising is a method of operation used by companies to distribute products or services. The company (the franchisor) grants to the operator (the franchisee) the right to sell a product or service and to operate a business along the lines developed by the franchisor and using the franchisor's trade name or other designation.

Ideally, it is a continuing and supportive relationship between the parties to work for the benefit of both. But there are degrees of relationship and of success.

The right or privilege granted is called the franchise and it may include the right to sell the parent company's products, use its name, adopt its methods or use its symbols and trademarks. It may include only some of these rights.

Territory of operations may or may not be exclusive, and support may or may not be set up on a continuing basis.

## Methods of operation

Some franchisors do virtually all the initial work of starting a new operation. They buy or lease the land and supervise construction of the building which has already been designed to their specifications. They install the equipment and fixtures, arrange the advance publicity and advertising and train the staff.

Some franchisors offer continuing support, from regular meetings and suggestions to newsletters and local advertising. A few leave you with all of the responsibilities and no help or advice.

These responsibilities may include payment of a royalty fee based on gross sales or maintaining a particular level of sales or they may include requiring you to attend training sessions, to purchase all equipment and supplies from the franchisor, or to maintain detailed financial records accessible to the franchisor.

The franchisor, in turn, is responsible for those items stipulated in the contract. If it isn't clearly and specifically stated in writing, don't assume that the franchisor will take care of it.

## Why do some companies offer franchises?

There are many advantages to the franchisor. It's not his money but yours which is used to organize and operate the outlet; he collects a fee for the right to let you do business and usually a continuing royalty, as well as rental income from the property. Many of the potential problems, such as zoning or labor problems and inventory controls, are the responsibility of the franchisee.

By offering franchises, many companies broaden their marketing and economic base with little capital of their own.

## Advantages and disadvantages of franchising

What you get will depend on the experience and integrity as well as the business and financial expertise of the franchisor. Advantages are few if you are purchasing a piece of paper permitting you to do business in a specified area. Your *only* advantages are what the franchisor provides for you, and they may or may not include:

- the experience and know-how of the franchisor who has operated many outlets and has a background of successes.
- training of the franchisee and staff.
- a continuing source of information to the franchisee.
- a tradename or symbol which is well-known and accepted by the buying public.

For every advantage there is a disadvantage which must be weighed carefully. Many franchisors collect a fee for the franchise and provide no further help. Even if support is provided, there may be disadvantages:

- services provided by the franchisor cost money and sometimes could be purchased more cheaply elsewhere.
- some of these services may not be of any value to the franchisee.
- many franchisors promise continuing support but fail to live up to that promise.
- if the franchisor operates from another jurisdiction and obligations are not fulfilled, it can be difficult, if not impossible, to achieve redress.
- profits are often less than franchisees have been led to believe.
- in some franchises, there is no room for flexibility of operation.
- tradenames and symbols may not bring in as much business as hoped.
- misleading promises by franchisors could mean loss of your investment.
- franchisors could "oversaturate" the market.

## Soliciting new franchisees

Franchisors use many methods to attract new franchisees. Classified and display advertising in magazines and newspapers, direct mailing lists and brochures at franchise locations are frequently-used procedures.

Some franchisors hold "exhibitions" in hotels and entice prospects to hear their sales pitch and sign up on the spot. No matter how good these opportunities sound, beware. *Never* sign anything, and that includes a cheque, without thoroughly investigating what you are buying.

Many franchisors offer sound opportunities for the careful investor and provide necessary support and advice. A lot of dissatisfaction between the two parties stems from a misunderstanding of the terms of the agreement.

## Purchasing a dream

Many people dream of owning a business and franchising may seem an easy way to do it. It's not. There is no easy way.

People who have bought franchises are often disillusioned; the profit projections predicted by the franchisor may be woefully inflated. It may take years of hard work before the business flourishes or it may never flourish.

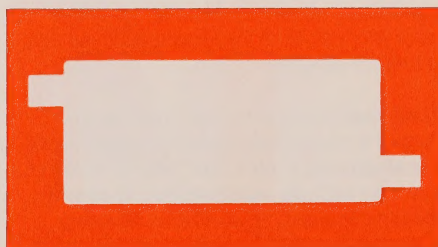
Some franchisees feel "straitjacketed" by restrictions on products, architecture, innovations or methods of operation imposed on them by the parent company.

If you buy a franchise you must be prepared to spend long hours to get the business started and operating successfully. Be sure that you really have the interest and the motivation necessary. It's not the franchisor who takes the loss if your business fails. It's you.

## Costs of franchising

These vary from company to company. Be sure that *all* costs are clearly stated in the contract. There may be:

- a franchise fee
- continuing royalty fees
- rental or leasing costs
- advertising assessment fees
- costs of buying or leasing equipment
- cost of products supplied.





## Some questions to ask before you invest

Variations in the franchising method make it a complex problem for the potential franchisee. Your investigation of the franchisor, the product, the territory, the contract and the existing outlets must be thorough. To do this, you'll need a lawyer and an accountant, both of whom should be experienced in dealing with franchises. Take all materials, contracts and proposals to them *before* you sign. Remember that responsible businessmen will give you the background information you require. Don't be hurried into signing a contract.

It is often difficult to solve misunderstandings or problems with a company which is operating from another jurisdiction. If you don't receive goods or services contracted for, it will be time-consuming and costly, if not impossible, to sue a foreign franchisor.

Talk with the Better Business Bureau, Canadian Association of Franchisors, the provincial ministry of consumer and commercial relations or your local Chamber of Commerce about the company's reputation and that of the product. Then get the answers to the following questions.



### The franchisor:

- Is the company financially stable? How does it make its money? (Money should come from successful franchises and products, not reselling unprofitable franchises.)
- If a subsidiary, who is the parent company?
- How long has the company been in business?
- How long has the present management been with the company?
- Does the company franchise other products or services?
- Would those products be in competition with your franchise?
- On what facts is the profit projection based?
- Will the reputation and credit record of the franchisor help you to obtain the necessary financial backing to purchase a franchise?
- How many franchises are in operation?
- Are there immediate plans for further expansion in your area?
- Where will new franchises be located?
- Is there a useful training program?
- Is it paid for by the company?
- What continuing assistance is provided? Ask for specifics.
- Does the franchisor help recruit and train staff on a continuing basis?
- Will you receive help in selecting and purchasing a location? Will they charge for a marketing study?
- Does the franchisor offer financial assistance in purchasing the franchise? At what rate?
- Who pays for initial opening costs, displays and layouts, local and national advertising?
- Are there new methods or innovations since the franchisor first started?
- Is a manual of operation provided?
- Is the price of the franchise variable? How?

### **The product or service**

- Is there a demand for it?
- How long has it been on the market?
- Is it seasonal? Is it a luxury? Is it a fad?
- Can it be successfully marketed in this area?
- Can you buy similar products in this area? At what price?
- What guarantee do you have that the franchisor will be able to continue getting the product for you at a fair price?
- What product warranties or guarantees are there?
- Who backs them, repairs them and pays for repairs?
- How many people in the area are potential customers?
- Is it protected by a trademark or copyright? Is it patented?

### **The territory**

- Is it exclusive? What guarantee do you have?
- Is it clearly-defined geographically or only by population?
- Is the population increasing or decreasing?
- Are there proposed changes in traffic patterns or redevelopment which could affect the business in the proposed location? (Check municipal offices about local by-laws.)
- What zoning laws and licences will affect you?
- What competition is in the area? How are other businesses doing?
- Is the market potential good?
- How expensive are taxes and insurance in the area?

### **The contract**

- Does it state the duration and renewal of the agreement and all costs to you?
- Is there a renewal fee?
- Must you purchase a minimum amount of merchandise per year?
- What other payments must you make?
- Is there a royalty payment? Is it reasonable?
- Is there a sales quota? Does the company have the right to terminate the contract if the quota isn't met?
- Under what other terms can the franchisor terminate the franchise?
- Is there provision for repurchasing equipment and inventory? How would the price be determined?
- Do you have the right to resell, renew or reassign the franchise?
- Under what conditions?
- Under what conditions can you terminate the franchise?
- Does your family have the right to continue the operation if you die? Under what conditions?
- Do you have renewal options for both the contract and the lease of the building? Do they expire concurrently?
- Has the franchisor the right to repurchase the franchise? At what price?
- Do you have the right to all innovations and new products offered by the franchisor?
- Is there a procedure for settling disputes?
- Must you purchase all equipment and supplies from the franchisor?
- Must you restrict your business to only the franchisor's products or services?



## The franchisee

Talking to the operators of existing franchises will be helpful in determining the reliability of the franchisor and the profitability of the product.

- What was the total cost of the franchise?
- What were the hidden or unexpected costs?
- Is there a continuing fee? Is it reasonable?
- If there is a minimum quota, is it difficult to achieve? How long was the franchisee in operation before the business became profitable?
- Are products and equipment supplied by the franchisor satisfactory and delivered promptly?
- Was the training program adequate? Were staff members also trained?
- Was the profit projection accurate?
- How are disagreements with the franchisor handled?
- Is this arrangement workable?
- What reports to the company are necessary?
- Is the marketing promotional and advertising assistance provided by the company satisfactory to the franchisee?
- What problems have been encountered?
- What changes should be made in the existing contract?

## Pitfalls and problems

The most frequent complaint of franchisees is that they were led to expect a certain profit which just didn't happen. Usually potential franchisees have unrealistic expectations: they want to hear how much money they are going to make and reality is a shock. Another problem is a lack of sufficient help and advice from the franchisor. Too often there is no one to turn to when the new franchisee runs into trouble.

## Protection for the franchisee

When you sign a franchise agreement you are entering a business contract. A lawyer and an accountant who understand the franchising method can help you spot potential problems and avoid them. They can show you what changes should be made to the existing contract to protect your rights and help you to become successful in this venture.

*Insist that the franchisor hold your franchise deposit in trust until your franchise outlet is open and operating.* Reliable businessmen will agree to this provision, which is particularly important if the product or service is not yet marketed and company stability is in doubt.

But the best protection is you.

*Don't sign anything in a hurry.*  
*Do investigate the franchisor's credit record and reputation.*  
*Do take the contract to a lawyer and accountant.*  
*Do ask the advice of your bank manager.*  
*Do make sure that the territory is clearly-defined and not already saturated.*

For more information about the franchising method of business, write:

Franchising, Commercial Studies  
Ontario Ministry of Consumer and  
Commercial Relations  
555 Yonge Street  
Toronto, Ontario  
M7A 2H6



3 1761 11470374 7



Ontario

Ministry of Consumer and Commercial Relations  
Larry Grossman, Q.C., Minister

2/78 25 M